

**REPORT OF THE AUDIT OF THE
KNOTT COUNTY
FISCAL COURT**

**For The Fiscal Year Ended
June 30, 2003**



**CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS
www.auditor.ky.gov**

**105 SEA HERO ROAD, SUITE 2
FRANKFORT, KY 40601-5404
TELEPHONE (502) 573-0050
FACSIMILE (502) 573-0067**

EXECUTIVE SUMMARY

AUDIT EXAMINATION OF THE KNOTT COUNTY FISCAL COURT

**For The Fiscal Year Ended
June 30, 2003**

The Auditor of Public Accounts has completed the Knott County Fiscal Court audit for fiscal year ended June 30, 2003. We have issued an unqualified opinion on the financial statements taken as a whole. Based upon the audit work performed, the financial statements are presented fairly in all material respects.

Financial Condition:

Fund balances increased by \$2,993,552 from the beginning of the year, resulting in a cash surplus of \$5,255,954 as of June 30, 2003.

Debt Obligations:

Total bonded debt principal as of June 30, 2003, was \$7,487,518. Future collections of \$10,450,906 are needed over the next 19 years to pay all bonded debt principal and interest.

Capital lease principal agreements totaled \$1,370,000 as of June 30, 2003. Future principal and interest payments of \$1,399,588 are needed to meet these obligations.

Report Comments:

- The Fiscal Court Should Maintain Correct Records
- The General Fund Owes The Road Fund \$50,000, The LGEA Fund \$332,823, And The E-911 Fund \$33,147
- The General Fund Should Not Have A Deficit Balance
- Expenditures Are Not Being Paid Within Thirty Days
- County Employees Should Comply With The County's Administrative Code
- The County Needs To Form An Ethics Commission In Accordance With The Code Of Ethics
- The County Should Have A Written Agreement To Protect Deposits
- The County Should Document All Adjustments Made To The 4th Quarter Financial Statements
- The County Treasurer Should Prepare A Schedule Of Expenditures Of Federal Awards
- Internal Controls Over Credit Card Transactions Need To Be Implemented
- Internal Controls Over Vehicle Use Need To Be Implemented
- The County Had Material Related Party Transactions
- The County Lacks Adequate Segregation Of Duties

Deposits:

The fiscal court's deposits were insured and collateralized by bank securities or bonds. However, the county did not have a written agreement to protect deposits.

CONTENTS

PAGE

INDEPENDENT AUDITOR'S REPORT	1
KNOTT COUNTY OFFICIALS	3
STATEMENT OF ASSETS, LIABILITIES, AND EQUITY ARISING FROM CASH TRANSACTIONS	6
STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND CHANGES IN CASH BALANCES - GOVERNMENTAL FUND TYPES	12
STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND CHANGES IN CASH BALANCES - PROPRIETARY FUND TYPE.....	17
STATEMENT OF CASH FLOWS - PROPRIETARY FUND TYPE	21
NOTES TO FINANCIAL STATEMENTS	22
COMPARATIVE SCHEDULE OF BUDGETED TO ACTUAL OPERATING REVENUE.....	33
SCHEDULE OF OPERATING REVENUE	37
COMPARATIVE SCHEDULE OF FINAL BUDGET AND BUDGETED EXPENDITURES	41
SCHEDULE OF OTHER EXPENDITURES.....	45
REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS	49
COMMENTS AND RECOMMENDATIONS	53
APPENDIX A:	
CERTIFICATION OF COMPLIANCE - LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAMS	



C R I T L U A L L E N
A U D I T O R O F P U B L I C A C C O U N T S

To the People of Kentucky
Honorable Ernie Fletcher, Governor
Robbie Rudolph, Secretary
Finance and Administration Cabinet
Honorable Donnie Newsome, Knott County Judge/Executive
Members of the Knott County Fiscal Court

Independent Auditor's Report

We have audited the accompanying statement of assets, liabilities, and equity arising from cash transactions of Knott County, Kentucky, as of June 30, 2003, the statement of cash receipts, cash disbursements, and changes in cash balances - governmental fund types; the statement of cash receipts, cash disbursements, and changes in cash balances - proprietary fund type; and the related statement of cash flows for the year then ended. These financial statements are the responsibility of the Knott County Fiscal Court. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and the Audit Guide for Fiscal Court Audits issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, Knott County, Kentucky, prepares its financial statements on a prescribed basis of accounting that demonstrates compliance with the modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and equity of Knott County, Kentucky as of June 30, 2003, and the revenues received and expenditures paid, and the cash flows of its enterprise fund for the year then ended in conformity with the modified cash basis of accounting.



To the People of Kentucky
Honorable Ernie Fletcher, Governor
Robbie Rudolph, Secretary
Finance and Administration Cabinet
Honorable Donnie Newsome, Knott County Judge/Executive
Members of the Knott County Fiscal Court

In accordance with Government Auditing Standards, we have also issued our report dated November 23, 2004, on our consideration of Knott County, Kentucky's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The accompanying financial information listed as supporting schedules in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements of Knott County, Kentucky. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Based on the results of our audit, we present the accompanying comments and recommendations, included herein, which discuss the following report comments:

- The Fiscal Court Should Maintain Correct Records
- The General Fund Owes The Road Fund \$50,000, The LGEA Fund \$332,823, And The E-911 Fund \$33,147
- The General Fund Should Not Have A Deficit Balance
- Expenditures Are Not Being Paid Within Thirty Days
- County Employees Should Comply With The County's Administrative Code
- The County Needs To Form An Ethics Commission In Accordance With The Code Of Ethics
- The County Should Have A Written Agreement To Protect Deposits
- The County Should Document All Adjustments Made To The 4th Quarter Financial Statements
- The County Treasurer Should Prepare A Schedule Of Expenditures Of Federal Awards
- Internal Controls Over Credit Card Transactions Need To Be Implemented
- Internal Controls Over Vehicle Use Need To Be Implemented
- The County Had Material Related Party Transactions
- The County Lacks Adequate Segregation Of Duties

Respectfully submitted,



Crit Luallen
Auditor of Public Accounts

Audit fieldwork completed -
November 23, 2004

KNOTT COUNTY OFFICIALS

For The Fiscal Year Ended June 30, 2003

Fiscal Court Members:

Donnie Newsome	County Judge/Executive
Ronnie Adams	Magistrate
James Huff	Magistrate
Keith Combs	Magistrate
Walter Combs	Magistrate

Other Elected Officials:

Randy Slone	County Attorney
Eldon Hicks	Jailer
Kenneth Gayheart	County Clerk
Carlos Jake Huff	Circuit Court Clerk
Ray Bolen	Sheriff
Carl Slone	Property Valuation Administrator
Jeff Blair	Coroner

Appointed Personnel:

Mac Combs	Deputy County Judge/Executive
Debra Moore	County Treasurer
Turner E. Campbell	Finance Officer

THIS PAGE LEFT BLANK INTENTIONALLY

STATEMENT OF ASSETS, LIABILITIES,
AND EQUITY ARISING FROM CASH TRANSACTIONS

KNOTT COUNTY
STATEMENT OF ASSETS, LIABILITIES,
AND EQUITY ARISING FROM CASH TRANSACTIONS

June 30, 2003

	Governmental Fund Type			
	General	Special Revenue	Capital Projects	Debt Service
<u>Assets and Other Resources</u>				
<u>Assets</u>				
Cash and Cash Equivalents	\$ 627,832	\$ 328,888	\$ 4,209,702	\$ 89,625
Due from the General Fund		33,147		
Total Assets	\$ 627,832	\$ 362,035	\$ 4,209,702	\$ 89,625
<u>Other Resources</u>				
Public Properties Corporation- Justice Center- Amounts to be Provided in Future Years for Revenue Bond Payments			3,731,237	
KADD Lease Agreement- Amounts to be Provided in Future Years for Lease Agreement				1,370,000
Public Properties Corporation- Road Improvement Project- Amounts to be Provided in Future Years for Revenue Bond Payments				220,375
Total Other Resources	\$	\$	\$ 3,731,237	\$ 1,590,375
Total Assets and Other Resources	\$ 627,832	\$ 362,035	\$ 7,940,939	\$ 1,680,000

The accompanying notes are an integral part of the financial statements.

KNOTT COUNTY
 STATEMENT OF ASSETS, LIABILITIES,
 AND EQUITY ARISING FROM CASH TRANSACTIONS
 June 30, 2003
 (Continued)

Proprietary Fund Type		Totals (Memorandum Only)	
		Primary Government	
<u>Enterprise</u>			

The accompanying notes are an integral part of the financial statements.

KNOTT COUNTY
 STATEMENT OF ASSETS, LIABILITIES,
 AND EQUITY ARISING FROM CASH TRANSACTIONS
 June 30, 2003
 (Continued)

	Governmental Fund Type			
	General	Special Revenue	Capital Projects	Debt Service
<u>Liabilities and Equity</u>				
<u>Liabilities</u>				
Due to E-911 Fund	\$ 33,147	\$	\$	\$
Road and Bridge Fund				
Revenue Bonds (Note 4 A)				310,000
KADD Lease Agreement (Note 5)				1,370,000
Public Properties Corporation-				
Justice Center Project-				
Revenue Bond (Note 4 B)			6,605,000	
Total Liabilities	\$ 33,147	\$	\$ 6,605,000	\$ 1,680,000
<u>Equity</u>				
Reserved			\$ 1,335,939	
Unreserved	\$ 594,685	362,035		
Total Equity	\$ 594,685	\$ 362,035	\$ 1,335,939	\$
Total Liabilities and Equity	\$ 627,832	\$ 362,035	\$ 7,940,939	\$ 1,680,000

The accompanying notes are an integral part of the financial statements.

KNOTT COUNTY
 STATEMENT OF ASSETS, LIABILITIES,
 AND EQUITY ARISING FROM CASH TRANSACTIONS
 June 30, 2003
 (Continued)

<u>Proprietary Fund Type</u>	Totals (Memorandum Only)
	<u>Primary Government</u>
<u>Enterprise</u>	
\$	\$ 33,147
	310,000
	1,370,000
	6,605,000
\$	\$ 8,318,147
	\$ 1,335,939
\$ 685	957,405
\$ 685	\$ 2,293,344
\$ 685	\$ 10,611,491

The accompanying notes are an integral part of the financial statements.

THIS PAGE LEFT BLANK INTENTIONALLY

STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS,
AND CHANGES IN CASH BALANCES - GOVERNMENTAL FUND TYPES

KNOTT COUNTY
STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND
CHANGES IN CASH BALANCES - GOVERNMENTAL FUND TYPES

For The Fiscal Year Ended June 30, 2003

	General Fund Type			
	General Fund	Road and Bridge Fund	Jail Fund	Local Government Economic Assistance Fund
<u>Cash Receipts</u>				
Schedule of Operating Revenue	\$ 1,168,005	\$ 1,215,870	\$ 64,407	\$ 2,173,565
Other Financing Sources:				
Transfers in		80,000	334,000	
Borrowed Money	1,340,959			
Kentucky Advance Revenue Program	496,000	140,900		
Bond Proceeds				
Total Cash Receipts	<u>\$ 3,004,964</u>	<u>\$ 1,436,770</u>	<u>\$ 398,407</u>	<u>\$ 2,173,565</u>
<u>Cash Disbursements</u>				
Comparative Schedule of Final Budget and Budgeted Expenditures	\$ 1,229,950	\$ 1,048,246	\$ 393,217	\$ 2,291,428
Other Financing Uses:				
Transfers Out	1,415,939	83,044		334,000
Schedule of Other Expenditures				
Bonds:				
Principal Paid				
Interest Paid				
Capital Lease Principal Payments	21,116	120,646	6,431	11,465
Kentucky Advance Revenue Program Repaid	496,000	140,900		
Total Cash Disbursements	<u>\$ 3,163,005</u>	<u>\$ 1,392,836</u>	<u>\$ 399,648</u>	<u>\$ 2,636,893</u>
Excess (Deficiency) of Cash Receipts Over (Under) Cash Disbursements	\$ (158,041)	\$ 43,934	\$ (1,241)	\$ (463,328)
Cash Balance - July 1, 2002	<u>166,660</u>	<u>* 6,464</u>	<u>* 1,948</u>	<u>* 1,030,658</u>
Cash Balance - June 30, 2003	<u>\$ 8,619</u>	<u>\$ 50,398</u>	<u>\$ 707</u>	<u>\$ 567,330</u>

* Restated because of prior period adjustments.

The accompanying notes are an integral part of the financial statements.

KNOTT COUNTY
STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND
CHANGES IN CASH BALANCES - GOVERNMENTAL FUND TYPES
For The Fiscal Year Ended June 30, 2003
(Continued)

Special Revenue Fund Type					Capital Project Fund Type
State Grant Fund	Federal Grant Fund	Disaster and Emergency Services Fund	E 911 Fund	Fire Protection Fund	Justice Center Construction Fund
\$ 242,000	\$ 20,108	\$ 90,976	\$ 145,743	\$ 410	\$ 80,835
					5,175,000
\$ 242,000	\$ 20,108	\$ 90,976	\$ 145,743	\$ 410	\$ 5,255,835
\$ 382,985	\$ 20,000	\$ 110,650	\$ 166,403	\$	\$
					2,523,478
					314,733
\$ 382,985	\$ 20,000	\$ 110,650	\$ 166,403	\$	\$ 2,838,211
\$ (140,985) 439,123	\$ 108 344	\$ (19,674) 21,705	\$ (20,660) 47,124	\$ 410 1,393	\$ 2,417,624 456,139
\$ 298,138	\$ 452	\$ 2,031	\$ 26,464	\$ 1,803	\$ 2,873,763

The accompanying notes are an integral part of the financial statements.

KNOTT COUNTY
 STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND
 CHANGES IN CASH BALANCES - GOVERNMENTAL FUND TYPES
 For The Fiscal Year Ended June 30, 2003
 (Continued)

	Capital Project Fund Type	Debt Service Fund Type	
		Public Properties Corporation - Road Improvement Bonds Fund	Totals (Memorandum Only)
<u>Cash Receipts</u>			
Schedule of Operating Revenue	\$	\$ 1,035	\$ 5,202,954
Other Financing Sources:			
Transfers in	1,335,939	83,044	1,832,983
Borrowed Money			1,340,959
Kentucky Advance Revenue Program			636,900
Bond Proceeds			5,175,000
Total Cash Receipts	<u>\$ 1,335,939</u>	<u>\$ 84,079</u>	<u>\$ 14,188,796</u>
<u>Cash Disbursements</u>			
Comparative Schedule of Final Budget and Budgeted Expenditures	\$	\$	\$ 5,642,879
Other Financing Uses:			
Transfers Out			1,832,983
Schedule of Other Expenditures			2,523,478
Bonds:			
Principal Paid		65,000	65,000
Interest Paid		19,260	333,993
Capital Lease Principal Payments			159,658
Kentucky Advance Revenue Program Repaid			636,900
Total Cash Disbursements	<u>\$</u>	<u>\$ 84,260</u>	<u>\$ 11,194,891</u>
Excess (Deficiency) of Cash Receipts Over (Under) Cash Disbursements	\$ 1,335,939	\$ (181)	\$ 2,993,905
Cash Balance - July 1, 2002		89,806	2,261,364
Cash Balance - June 30, 2003	<u>\$ 1,335,939</u>	<u>\$ 89,625</u>	<u>\$ 5,255,269</u>

The accompanying notes are an integral part of the financial statements.

STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS,
AND CHANGES IN CASH BALANCES - PROPRIETARY FUND TYPE

KNOTT COUNTY
 STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS,
AND CHANGES IN CASH BALANCES - PROPRIETARY FUND TYPE

For The Year Ended June 30, 2003

	<u>Enterprise Fund Type</u>
	<u>Jail Canteen Fund</u>
<u>Cash Receipts</u>	
Receipts - Jail Canteen	<u>\$</u>
Total Cash Receipts	<u>\$ 0</u>
<u>Cash Disbursements</u>	
Jail Canteen Expenditures	<u>\$ 353</u>
Total Cash Disbursements	<u>\$ 353</u>
Deficiency of Cash Receipts Under Cash Disbursements	\$ (353)
Cash Balance - July 1, 2002	<u>1,038</u>
Cash Balance - June 30, 2003	<u><u>\$ 685</u></u>

The accompanying notes are an integral part of the financial statements.

THIS PAGE LEFT BLANK INTENTIONALLY

STATEMENT OF CASH FLOWS - PROPRIETARY FUND TYPE

KNOTT COUNTY
STATEMENT OF CASH FLOWS - PROPRIETARY FUND TYPE

For The Year Ended June 30, 2003

	<u>Enterprise Fund</u>
	<u>Jail Canteen</u>
Cash Flows From Operating Activities:	
Payments to Suppliers	<u>\$ (353)</u>
Net Cash Used By Operating Activities	<u>\$ (353)</u>
Cash and Cash Equivalents - July 1, 2002	<u>\$ 1,038</u>
Cash and Cash Equivalents - June 30, 2003	<u><u>\$ 685</u></u>

KNOTT COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2003

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

The financial statements of Knott County include the funds, agencies, boards, and entities for which the fiscal court is financially accountable. Financial accountability, as defined by Section 2100 of the GASB Codification of Governmental Accounting and Financial Reporting Standards, as amended by GASB 14, was determined on the basis of the government's ability to significantly influence operations, select the governing authority, participate in fiscal management and the scope of public service. Based upon the criteria stated in GASB 14, management has included the Justice Center Construction Fund, Detention Center Construction Fund, and the Public Properties Corporation – Road Improvement Bonds Fund as part of the reporting entity.

Knott County Justice Center Construction Fund

The Knott County Justice Center (the Center) is a legally separate entity established to oversee construction of the justice center facility. A majority of the Center's governing body is appointed by the Knott County Judge/Executive. Further, the Knott County Fiscal Court can significantly influence the Center's operations. Therefore, management must include the Knott County Justice Center as a component unit, and the Center's financial activity is blended with that of the Fiscal Court.

Knott County Detention Center Construction Fund

The Knott County Detention Center (the Center) is a legally separate entity established to oversee construction of the detention center facility. A majority of the Center's governing body is appointed by the Knott County Judge/Executive. Further, the Knott County Fiscal Court can significantly influence the Center's operations. Therefore, management must include the Knott County Detention Center as a component unit, and the Center's financial activity is blended with that of the Fiscal Court.

Knott County Road Improvement Bonds Fund

The Knott County Road Improvement Project (the Project) is a legally separate entity established to provide long-term debt service to the Fiscal Court. A majority of the Project's governing body is appointed by the Knott County Judge/Executive. Further, the Knott County Fiscal Court can significantly influence the Project's operations. Therefore, management must include the Knott County Road Improvement Project as a component unit, and the Project's financial activity is blended with that of the Fiscal Court.

Additional - Knott County Elected Officials

- Circuit Court Clerk
- County Attorney
- County Clerk
- County Sheriff
- Property Valuation Administrator

KNOTT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

A. Reporting Entity (Continued)

Kentucky law provides for election of the above officials from the geographic area constituting Knott County. Pursuant to state statute, these officials perform various services for the Commonwealth of Kentucky, its judicial courts, the fiscal court, various cities and special districts within the county, and the board of education. In exercising these responsibilities, however, they are required to comply with state laws. Audits of their financial statements are issued separately and individually and can be obtained from their respective administrative offices.

B. Fund Accounting

Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. The government uses funds to report on its financial position and the results of its operations. A fund is a separate accounting entity with a self-balancing set of accounts. Knott County Fiscal Court's fund types, a definition of each, and county funds included within each fund type are listed below.

1) General Fund Type

General Fund Type accounts for all financial resources except those required to be accounted for in another fund type. The Knott County General Fund Type includes the following county funds: General Fund, Road and Bridge Fund, Jail Fund, and Local Government Economic Assistance Fund.

2) Special Revenue Fund Type

Special Revenue Fund Type accounts for the proceeds of specific revenue sources that are legally restricted to expenditures for the specified purpose. The Knott County Special Revenue Fund Type includes the following county funds: State Grant Fund, Federal Grant Fund, Disaster and Emergency Services Fund, E 911 Fund, and Fire Protection Fund.

3) Debt Service Fund Type

Debt Service Fund Type accounts for the accumulation of resources for the payment of general long-term debt principal and interest and includes funds for the Public Properties Corporation – Road Improvement Bonds Fund. Debt service is provided through annual transfers from the General Fund Type in the amount of the debt service requirements for the year.

4) Capital Projects Fund Type

Capital Projects Fund Type accounts for financial resources to be used for acquisition of major capital facilities. The Justice Center Construction Fund and the Detention Center Construction Fund of the Fiscal Court are reported as Capital Projects Fund Types.

KNOTT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

B. Fund Accounting (Continued)

5) Enterprise Fund Type

The Enterprise Fund Type is used to report an activity for which a fee is charged to external users for goods or services. The Knott County Enterprise Fund Type includes the jail canteen fund, which is maintained by the county jailer.

The canteen operations are authorized pursuant to KRS 441.135(1), which allows the jailer to sell snacks, sodas, and other items to inmates. The profits generated from the sale of those items are to be used for the benefit or recreation of the inmates. KRS 441.135(2) requires the jailer to maintain accounting records and report annually to the county treasurer the receipts and disbursements of the jail canteen fund. Technical Audit Bulletin 93-002 provides additional accounting and expenditure guidance for acceptable jail canteen operations. All profit expenditures were for the benefit and/or recreation of the inmates.

C. Basis of Accounting

For all fund types, the county utilizes a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under this basis of accounting, assets, liabilities, and related revenues and expenditures are recorded when they result from cash transactions, with a few exceptions. This modified cash basis recognizes revenues when received and expenditures when paid. Long-term receivables, long-term obligations and amounts to be provided in future years to retire debt are recorded in the financial statements. The amount to be provided in future years to retire debt is offset by any cash or cash equivalents held by the county in a bond or debt service fund.

The State Local Finance Officer does not require the county to maintain a general fixed assets group of accounts; therefore the value of the county's fixed assets is not included in the financial statements. These fixed assets include buildings, equipment and land that are owned by the county.

D. Legal Compliance - Budget

The Knott County budget is adopted on a cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer. The County Judge/Executive is required to submit estimated receipts and proposed expenditures to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

The fiscal court may change the original budget by transferring appropriations at the activity level; however, the fiscal court may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

KNOTT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

D. Legal Compliance - Budget (Continued)

Formal budgets are not adopted for the Justice Center Construction Fund, Detention Center Construction Fund, and Jail Canteen Fund because the Governor's Office for Local Development does not require these funds to be budgeted. In addition, no formal budget is adopted for the Public Properties Corporation-Road Improvement Bonds Fund because bond indentures and other relevant contractual provisions require specific payments to and from these funds annually and transfers are budgeted in the General Fund Type to comply with these requirements. The Governor's Office for Local Development does not require this fund to be budgeted.

E. Cash and Investments

Cash includes amounts in bank accounts, and investments are stated at cost.

KRS 66.480 authorizes the county to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

F. Related Organizations

A related organization is an entity for which a primary government is not financially accountable. It does not impose will or have a financial benefit or burden relationship, even if the primary government appoints a voting majority of the related organization's governing board. Based on these criteria, the following are considered related organizations of Knott County Fiscal Court: Knott County Health District, Knott County Library District, Knott County Conservation District, and Knott County Water District.

Note 2. Employee Retirement System

The county has elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement Systems. This is a multiple-employer public retirement system which covers all eligible full-time employees. Benefit contributions and provisions are established by statute. Nonhazardous covered employees are required to contribute 5 percent of their salary to the plan. The county's contribution rate for nonhazardous employees was 6.34 percent. Hazardous covered employees are required to contribute 8 percent of their salary to the plan. The county's contribution rate for hazardous employees was 16.28 percent.

KNOTT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003
(Continued)

Note 2. Employee Retirement System (Continued)

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Aspects of benefits for hazardous employees include retirement after 20 years of service or age 55.

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report.

Note 3. Deposits

The county maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to KRS 66.480(1)(d) and KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the county and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. The depository institution has pledged or provided sufficient collateral, and the depository institution's board of directors or loan committee approved the pledge or provision. However, the depository institution did not have a written agreement with the county securing the county's interest in the collateral.

Note 4. Long-Term Debt - Revenue Bonds

A. Road Improvement Projects:

In March 2000, the Knott County Public Properties Corporation issued Revenue Bonds for the purpose of road improvement projects. The bond issue was \$500,000 of revenue bonds at various rates. Principal payment requirements and scheduled interest for the remaining payments are presented below:

<u>Fiscal Year Ending June 30</u>	<u>Scheduled Interest And Other Fees</u>	<u>Scheduled Principal</u>
2004	\$ 15,929	\$ 70,000
2005	12,341	75,000
2006	8,498	80,000
2007	4,378	85,000
Totals	<u>\$ 41,146</u>	<u>\$ 310,000</u>

KNOTT COUNTY
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2003
 (Continued)

Note 4. Long-Term Debt - Revenue Bonds (Continued)

B. Justice Center Project:

In April 2002, the Knott County Public Properties Corporation issued First Mortgage Revenue Bond Notes, Series 2002, for the Justice Center Project. The Bond Note issued was for \$6,605,000 with an interest rate of 4.70 percent. Principal payment requirements and scheduled interest payments are presented below:

<u>Fiscal Year Ending June 30</u>	<u>Scheduled Interest And Other Fees</u>	<u>Scheduled Principal</u>
2004	\$ 309,210	\$ 235,000
2005	297,813	250,000
2006	285,644	265,000
2007	272,819	275,000
2008	259,756	275,000
2009-2013	1,092,396	1,475,000
2014-2018	714,322	1,720,000
2019-2023	<u>262,800</u>	<u>2,110,000</u>
Totals	<u>\$ 3,494,760</u>	<u>\$ 6,605,000</u>

Note 5. KADD Lease Agreement

On June 20, 2003, Knott County entered into a lease agreement with the Kentucky Area Development Districts Financing Trust for the financing of the Detention Center Anticipation Note. The principal amount of the lease was \$1,370,000. The agreement requires the total principal and interest balances to be paid in full May 1, 2004. The principal balance of the agreement was \$1,370,000 as of June 30, 2003. Lease payments for the remaining year are:

<u>Fiscal Year Ending June 30</u>	<u>Scheduled Interest And Other Fees</u>	<u>Scheduled Principal</u>
2004	<u>\$ 29,588</u>	<u>\$ 1,370,000</u>

KNOTT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003
(Continued)

Note 6. Lease Agreements

The county has entered into the following lease agreements:

- A. On February 16, 1999, Knott County entered into a lease agreement with Caterpillar Financial Services Corporation for the purchase of a backhoe loader. The principal amount of the lease was \$82,543. The agreement requires monthly payments of \$1,579 for 60 months to be paid in full February 4, 2004. The principal balance of the agreement was \$10,889 as of June 30, 2003.
- B. On February 16, 1999, Knott County entered into a lease agreement with Caterpillar Financial Services for the purchase of a grader. The principal amount of the lease was \$124,818. The agreement requires monthly payments of \$2,387 for 60 months to be paid in full February 4, 2004. The principal balance of the agreement was \$16,466 as of June 30, 2003.
- C. On June 13, 2000, Knott County entered into a lease agreement with Leasing One Corporation for the purchase of a Ford Van to be used by the Jailer for transporting inmates to Letcher and Floyd Counties. The principal amount of the lease was \$24,864. The agreement requires monthly payments of \$587 for 48 months to be paid in full June 30, 2004. The principal balance of the agreement was \$6,846 as of June 30, 2003.
- D. On October 26, 2001, Knott County entered into a lease agreement with Leasing One Corporation for the purchase of a 2001 Plymouth Voyager van. The principal amount of the lease was \$17,855. The agreement requires monthly payments of \$540 for 36 months to be paid in full November 30, 2004. The principal balance of the agreement was \$8,347 as of June 30, 2003.
- E. On June 19, 2002, Knott County entered into a lease agreement with Leasing One Corporation for the purchase of a 2002 Chevrolet Tahoe. The principal amount of the lease was \$37,947. The agreement requires monthly payments of \$1,219 for 36 months to be paid in full June 30, 2005. The principal balance of the agreement was \$25,917 as of June 30, 2003.
- F. On December 6, 2002, Knott County entered into a lease agreement with Leasing One Corporation for the purchase of a 2003 Jeep Grand Cherokee. The principal amount of the lease was \$29,995. The agreement requires monthly payments of \$687 for 48 months to be paid in full June 30, 2006. The principal balance of the agreement was \$25,917 as of June 30, 2003.
- G. On February 15, 2001, Knott County entered into a lease purchase agreement with Public-Finance.com, Inc. for the purchase of a 1999 Ford Wheeled Coach Ambulance. The principal of the lease was \$46,731. The agreement requires monthly payments of \$1,095 for 48 months to be paid in full February 15, 2005. The principal balance of the agreement was \$8,968 as of June 30, 2003.
- H. On June 15, 2001, Knott County entered into a lease purchase agreement with Public-Finance.com, Inc. for the purchase of a 2001 Ford Supervan and Crusader Ambulance. The principal of the lease was \$48,731. The agreement requires monthly payments of \$1,133 for 48 months to be paid in full July 20, 2005. The principal balance of the agreement was \$28,740 as of June 30, 2003.

KNOTT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003
(Continued)

Note 7. Related Party Transactions

During the fiscal year ended June 30, 2003, the Fiscal Court expended \$48,008 in transactions with Bradley Trucking, which is owned by the County Judge Executive's son-in-law. The Fiscal Court also expended \$1,118 with the Big S Market which is owned by the County Judge Executive. Together these transactions are considered material to the financial statements. In addition, the Fiscal Court purchased a 1990 Dodge Truck from the County Finance Officer for \$3,204.

Note 8. Insurance

For the fiscal year ended June 30, 2003, Knott County was a member of the Kentucky Association of Counties' All Lines Fund (KALF). KALF is a self-insurance fund and was organized to obtain lower cost coverage for general liability, property damage, public officials' errors and omissions, public liability, and other damages. The basic nature of a self-insurance program is that of a collectively shared risk by its members. If losses incurred for covered claims exceed the resources contributed by the members, the members are responsible for payment of the excess losses.

THIS PAGE LEFT BLANK INTENTIONALLY

COMPARATIVE SCHEDULE OF
BUDGETED TO ACTUAL OPERATING REVENUE

KNOTT COUNTY
COMPARATIVE SCHEDULE OF
BUDGETED TO ACTUAL OPERATING REVENUE

For The Fiscal Year Ended June 30, 2003

<u>Budgeted Funds</u>	Budgeted Operating Revenue	Actual Operating Revenue	Over (Under) Budget
<u>General Fund Type</u>			
General Fund	\$ 2,085,812	\$ 1,168,005	\$ (917,807)
Road and Bridge Fund	1,712,289	1,215,870	(496,419)
Jail Fund	674,625	64,407	(610,218)
Local Government Economic Assistance Fund	2,617,357	2,173,565	(443,792)
<u>Special Revenue Fund Type</u>			
State Grant Fund	541,000	242,000	(299,000)
Federal Grant Fund	480,000	20,108	(459,892)
Disaster and Emergency Services Fund	90,843	90,976	133
E 911 Fund	142,050	145,743	3,693
Fire Protection Fund	4,720	410	(4,310)
Totals	<u>\$ 8,348,696</u>	<u>\$ 5,121,084</u>	<u>\$ (3,227,612)</u>
<u>Reconciliation</u>			
Total Budgeted Operating Revenue Above			\$ 8,348,696
Add: Budgeted Prior Year Surplus			1,409,779
Less: Other Financing Uses			<u>(636,900)</u>
Total Operating Budget Per Comparative Schedule Of Final Budget and Budgeted Expenditures			<u>\$ 9,121,575</u>

THIS PAGE LEFT BLANK INTENTIONALLY

SCHEDULE OF OPERATING REVENUE

KNOTT COUNTY
SCHEDULE OF OPERATING REVENUE

For The Fiscal Year Ended June 30, 2003

Revenue Categories	GOVERNMENTAL FUND TYPE				Totals (Memorandum Only)
	General Fund Type	Special Revenue Fund Type	Capital Projects Fund Type	Debt Service Fund Type	
Taxes	\$ 848,950	\$ 144,341	\$	\$	\$ 993,291
In Lieu Tax Payments	8,700				8,700
Excess Fees	19,032				19,032
Licenses and Permits	258				258
Intergovernmental Revenues	3,522,716	351,310			3,874,026
Charges for Services	79,576				79,576
Miscellaneous Revenues	132,319	1,677	80,835	1,035	215,866
Interest Earned	10,296	1,909			12,205
Total Operating Revenue	<u>\$ 4,621,847</u>	<u>\$ 499,237</u>	<u>\$ 80,835</u>	<u>\$ 1,035</u>	<u>\$ 5,202,954</u>

THIS PAGE LEFT BLANK INTENTIONALLY

COMPARATIVE SCHEDULE OF
FINAL BUDGET AND BUDGETED EXPENDITURES

KNOTT COUNTY
COMPARATIVE SCHEDULE OF
FINAL BUDGET AND BUDGETED EXPENDITURES

For The Fiscal Year Ended June 30, 2003

Expenditure Categories	GENERAL FUND TYPE		
	Final Budget	Budgeted Expenditures	Under (Over) Budget
General Government	\$ 773,967	\$ 917,635	\$ (143,668)
Protection to Persons and Property	313,740	422,831	(109,091)
General Health and Sanitation	1,338,633	567,455	771,178
Social Services	166,000	179,074	(13,074)
Recreation and Culture	486,020	425,368	60,652
Roads	1,801,430	1,313,976	487,454
Debt Service	813,318	31,685	781,633
Capital Projects	75,000	37,400	37,600
Administration	1,986,854	1,067,417	919,437
Total Operating Budget - General Fund Type	\$ 7,754,962	\$ 4,962,841	\$ 2,792,121
Other Financing Uses:			
Borrowed Money-			
Kentucky Advanced Revenue			
Program - Principal		636,900	(636,900)
Capital Lease Agreement-			
Principal on Leases		159,658	(159,658)
Transfers to Public Property			
Corporation Fund		83,044	(83,044)
TOTAL BUDGET - GENERAL FUND TYPE	<u>\$ 7,754,962</u>	<u>\$ 5,842,443</u>	<u>\$ 1,912,519</u>
Expenditure Categories	SPECIAL REVENUE FUND TYPE		
	Final Budget	Budgeted Expenditures	Under (Over) Budget
Protection to Persons and Property	\$ 141,570	\$ 150,733	\$ (9,163)
Roads	211,843	110,650	101,193
Capital Projects	220,000	402,985	(182,985)
Administration	793,200	15,670	777,530
TOTAL BUDGET - SPECIAL REVENUE FUND TYPE	<u>\$ 1,366,613</u>	<u>\$ 680,038</u>	<u>\$ 686,575</u>

THIS PAGE LEFT BLANK INTENTIONALLY

SCHEDULE OF OTHER EXPENDITURES

KNOTT COUNTY
SCHEDULE OF OTHER EXPENDITURES

For The Fiscal Year Ended June 30, 2003

<u>Expenditure Items</u>	<u>Justice Center Construction Fund</u>
Construction Expense	\$ 2,521,478
Miscellaneous Expense	<u>2,000</u>
Totals	<u><u>\$ 2,523,478</u></u>

THIS PAGE LEFT BLANK INTENTIONALLY

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS



C R I T L U A L L E N
A U D I T O R O F P U B L I C A C C O U N T S

The Honorable Donnie Newsome, Knott County Judge/Executive
Members of the Knott County Fiscal Court

Report On Compliance And On Internal Control
Over Financial Reporting Based On An Audit Of Financial
Statements Performed In Accordance With Government Auditing Standards

We have audited the financial statements of Knott County, Kentucky, as of and for the year ended June 30, 2003, and have issued our report thereon dated November 23, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Knott County's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under Government Auditing Standards and which are described in the accompanying comments and recommendations.

- The Fiscal Court Should Maintain Correct Records
- The General Fund Owes The Road Fund \$50,000, The LGEA Fund \$332,823, And The E-911 Fund \$33,147
- The General Fund Should Not Have A Deficit Balance
- Expenditures Are Not Being Paid Within Thirty Days
- County Employees Should Comply With The County's Administrative Code
- The County Needs To Form An Ethics Commission In Accordance With The Code Of Ethics
- The County Should Have A Written Agreement To Protect Deposits

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Knott County's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial



Report On Compliance And On Internal Control
Over Financial Reporting Based On An Audit Of Financial
Statements Performed In Accordance With Government Auditing Standards
(Continued)

Internal Control Over Financial Reporting (Continued)

reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Knott County's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying comments and recommendations.

- The County Should Document All Adjustments Made To The 4th Quarter Financial Statements
- The County Treasurer Should Prepare A Schedule Of Expenditures Of Federal Awards
- Internal Controls Over Credit Card Transactions Need To Be Implemented
- Internal Controls Over Vehicle Use Need To Be Implemented
- The County Had Material Related Party Transactions
- The County Lacks Adequate Segregation Of Duties

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However we consider all findings noted above to be material weaknesses.

This report is intended solely for the information and use of management is not intended to be and should not be used by anyone other than the specified parties.

Respectfully submitted,



Crit Luallen
Auditor of Public Accounts

Audit fieldwork completed -
November 23, 2004

COMMENTS AND RECOMMENDATIONS

KNOTT COUNTY
COMMENTS AND RECOMMENDATIONS

For The Fiscal Year Ended June 30, 2003

NONCOMPLIANCES

1. The Fiscal Court Should Maintain Correct Records

The cash balances reflected on the county's financial statements did not agree with the reconciled bank balance for the General, Road, Jail, and LGEA fund. These amounts should agree and any variance should be reconciled. The State Local Finance Officer, under the authority of KRS 68.210 requires the County Treasurer and Finance Officer to keep accurate records and detailed accounts of the financial transactions of the County. We recommend the County Treasurer and the Finance Officer investigate and reconcile any variances between the book balance and bank balance.

County Finance Officer Eddie Campbell's Response:

Knott County agrees and has reconciled the financial statements.

2. The General Fund Owes The Road Fund \$50,000, The LGEA Fund \$332,823, And The E-911 Fund \$33,147

According to The Governor's Office for Local Development (GOLD), if counties use restricted funds for anything other than the designated purpose, the use must be repaid to the restricted account within the same fiscal year. On September 29, 2000, the County transferred \$50,000 from the Road Fund, a restricted account, to the General Fund. On June 29, 2001, the County transferred \$53,000 from the LGEA Fund, another restricted account, to the General Fund. Additionally, GOLD personnel reported that the County had transferred \$270,000 from the LGEA Fund to the General Fund. The county could not document that these funds were used for their intended purposes.

KRS 42.455(2) requires that the LGEA funds be spent on the coal haul road system and other priority categories such as public safety, environmental protection, public transportation, health, and various social services. The county expended \$9,823 of LGEA funds for payment of punitive damages related to lawsuits against the county. This use of LGEA funds violates KRS 42.455(2).

The County expended E-911 funds of \$4,322 for street signs and \$9,000 for emergency medical technician (EMT) training for a total of \$13,322. These expenditures did not comply with OAG 97-13. The Attorney General issued OAG 97-13, which expressly prohibits the use of E-911 service charge revenues for the purchase of street signs, because street signs are a part of the road system, rather than of the E-911 emergency telephone service. EMT training, while crucial for the delivery of emergency services, does not meet the criteria set forth in OAG 97-13 either. In addition to these expenditures, a lawsuit liability in the amount of \$19,825 was also paid out of the E-911 fund. This disbursement does not comply with KRS 65.760(3). The total amount of unauthorized E-911 expenditures equals \$33,147, which should be transferred to the E-911 fund from an appropriate unrestricted fund as soon as funds permit.

We recommend that the General Fund transfer \$50,000 to the Road Fund, \$332,823 to the LGEA Fund and \$33,147 to the E-911 Fund.

County Finance Officer Eddie Campbell's Response:

Knott County will attempt to rectify these financial transactions as soon as it is economically feasible.

KNOTT COUNTY
COMMENTS AND RECOMMENDATIONS
For The Fiscal Year Ended June 30, 2003
(Continued)

NONCOMPLIANCES (Continued)

3. The General Fund Should Not Have A Deficit Balance

As of June 30, 2003, the general fund had a deficit balance of \$407,349. The deficit fund balance is the result of transfers from previous years and expenditures that were not authorized to be paid from restricted accounts. KRS 68.110 states that the fiscal court shall not in any year expend any money in excess of the amount annually levied and collected for that year. We recommend that the fiscal court monitor the financial transactions of the county to ensure compliance with this statute.

County Finance Officer Eddie Campbell's Response:

Knott County agrees.

4. Expenditures Are Not Being Paid Within Thirty Days

During testing we found that invoices are not being paid within thirty days. KRS 65.140 states that unless the purchaser and vendor otherwise contract, all bills for goods or services shall be paid within thirty (30) working days of receipt of a vendor's invoice. We recommend that the county implement procedures to ensure that invoices are paid within thirty (30) working days.

County Finance Officer Eddie Campbell's Response:

Knott County agrees that this has happened and will attempt to avoid in the future.

5. County Employees Should Comply With The County's Administrative Code

Section 820.2 of the County's Administrative Code states that "no official or employee shall request, use or permit the use of any publicly-owned or publicly-supported property, vehicle, equipment, material or service for the personal convenience or the private advantage of himself or any other person unless such use has been formally authorized." During testing, we found that the fiscal court did not approve the County Treasurer's or Finance Officer vehicles. Therefore, these employees are in violation of the County's administrative code. We recommend that the fiscal court enforce the county's administrative code.

County Finance Officer Eddie Campbell's Response:

May 19, 2004 Fiscal Court Resolution.

Auditor's Note:

On May 19, 2004, the Knott County Fiscal Court passed a resolution acknowledging that some county owned vehicles are assigned to county officials and employees. The fiscal court also resolved that these vehicles be used only for fiscal court business and that vehicles driven home by officials and employees are expected to be parked by 6:00 pm unless fiscal court business requires otherwise.

The Auditor of Public Accounts notes that the use of county vehicles for commuting represents taxable income to the employee pursuant to Internal Revenue Code Section 61(a).

KNOTT COUNTY
COMMENTS AND RECOMMENDATIONS
For The Fiscal Year Ended June 30, 2003
(Continued)

NONCOMPLIANCES (Continued)

6. The County Needs To Form An Ethics Commission In Accordance With The Code Of Ethics

We found that the County has not formed an Ethics Commission. KRS 65.003, enacted in 1994, requires all counties to have adopted a code of ethics. The County fulfilled this requirement when it enacted its Code of Ethics in December 1994. When the county adopted this code of ethics it required an establishment of a Knott County Ethics Commission. The county has never formed this ethics commission. Therefore, we recommend that the county appoint members to establish the Knott County Ethics Commission in accordance with the Code of Ethics.

County Finance Officer Eddie Campbell's Response:

Knott County agrees.

7. The County Should Have A Written Agreement To Protect Deposits

The County maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to KRS 66.480(1)(d) and KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the County and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. The depository institution has pledged or provided sufficient collateral, and the depository institution's board of directors or loan committee approved the pledge or provision. However, the depository institution did not have a written agreement with the County securing the County's interest in the collateral.

County Finance Officer Eddie Campbell's Response:

Knott County will ensure this written agreement is put in place.

REPORTABLE CONDITIONS

8. The County Should Document All Adjustments Made To The 4th Quarter Financial Statements

The Finance Officer made undocumented adjustments to the 4th quarter financial statement. These adjustments were labeled payroll related items. Bank reconciliation of the payroll account did not result in any such items. It appears to the auditor that these adjustments were made to reconcile with the book balance reflected on the 4th quarter financial statement. We recommend that any adjustments made to the 4th quarter report have documentation to support the adjustment.

County Finance Officer Eddie Campbell's Response:

The County disagrees. The adjustments were payroll related due to some old withholdings. However, they should have not been carried for so long.

KNOTT COUNTY
COMMENTS AND RECOMMENDATIONS
For The Fiscal Year Ended June 30, 2003
(Continued)

REPORTABLE CONDITIONS (Continued)

9. The County Treasurer Should Prepare A Schedule Of Expenditures Of Federal Awards

The county did not prepare a schedule of expenditures of federal awards. It is the county's responsibility to identify the total dollar amount of federal expenditures and to obtain a single audit if federal expenditures equal or exceed \$300,000 during the fiscal year. Because of this, it is very important that the county treasurer compile a schedule of expenditures of federal awards. This schedule should contain the following information on all federal grants: Grant name and awarding agency, Catalog of Federal Domestic Assistance number, pass through grantor number (if applicable), and grant receipts and expenditures. We strongly recommend that the county implement procedures immediately to ensure that their schedule of expenditures of federal awards is prepared.

County Finance Officer Eddie Campbell's Response:

The County Treasurer already maintains very, detailed, accurate files on each grant.

Auditor's Note:

The County Treasurer should use the information maintained for each grant to compile a schedule of expenditures of federal awards.

10. Internal Controls Over Credit Card Transactions Need To Be Implemented

During testing of credit card transactions, we found that for five of the six transactions tested, no receipts were maintained. Therefore, the county could not document whether these purchases were for county purposes or not. In addition, we found that employees are using the County Judge/Executive's credit card to purchase items. We recommend that the following procedures be implemented immediately to strengthen internal controls over credit card use.

- No county employee should use another employee's credit card for any reason.
- All receipts for credit card transactions need to be filed for preparation of the claims list.
- Once the credit card statement is received all receipts related to that statement need to be attached to the credit card statement.
- A detailed list of transactions needs to be included on the claims list presented to the fiscal court for approval.

County Finance Officer Eddie Campbell's Response:

The County agrees that better internal controls need to be implemented over the Judge/Executive's credit card.

KNOTT COUNTY
 COMMENTS AND RECOMMENDATIONS
 For The Fiscal Year Ended June 30, 2003
 (Continued)

REPORTABLE CONDITIONS (Continued)

11. Internal Controls Over Vehicle Use Need To Be Implemented

During testing of vehicle use, auditor found that the County Treasurer and Finance Officer have a county vehicle that is driven home each day. The county provided no evidence that the fiscal court approved these employees to have a county vehicle. These employees do not maintain a log for these vehicles. Therefore, the county cannot document whether the vehicles are being used only for county purposes. The Finance Officer has a county credit card with which gas was purchased. The county could not provide receipts for these gas purchases and could not document whether these gas purchases were for county purposes. We recommend the following procedures be implemented immediately to strengthen the internal controls over vehicle use:

- A log should be maintained for each vehicle. This log should include the date of each and every use, the mileage at the start and at the end of each use, the expense (gas, oil, maintenance, etc.) incurred during the use, and the purpose of each use.
- Employees should receive fiscal court approval for county vehicle use.
- Each county vehicle should be maintained on county property at the end of each day.
- All receipts for gas charged to the county need to be maintained and filed.

County Finance Officer Eddie Campbell's Response:

May 19, 2004 Fiscal Court Resolution implemented this. In addition gasoline credit card receipts are kept by the Finance Director.

Auditor's Note:

As of January 7, 2005, the Knott County Finance Officer (Director) had not provided receipts for gas purchases noted above.

12. The County Had Material Related Party Transactions

During testing, we found that the County had material related party transactions. The county did business with Bradley Trucking, which is owned by the County Judge/Executive's son-in-law. The total the County paid Bradley Trucking was \$48,008. The County Judge/Executive owns the Big S Market located in Topmost. The county also did business with the Big S Market. The total the county paid to the Big S Market was \$1,118; of this amount \$968 was in credit card transactions that were charged to a county credit card issued to the judge/executive. We recommend that the county establish an Ethics Commission to review its Code of Ethics and make determination as whether these transactions are appropriate.

In addition, we found the Fiscal Court purchased a 1990 Dodge Truck from the Finance Officer for \$3,204.

County Finance Officer Eddie Campbell's Response:

Knott County feels strongly that these transactions were appropriate because the County did not utilize these payees exclusively at any time.

KNOTT COUNTY
COMMENTS AND RECOMMENDATIONS
For The Fiscal Year Ended June 30, 2003
(Continued)

REPORTABLE CONDITIONS (Continued)

13. The County Lacks Adequate Segregation Of Duties

The county has a lack of adequate segregation of duties. Due to the entity's diversity of official operations, small size and budget restrictions the county has limited options for establishing an adequate segregation of duties. We recommend the following controls be implemented to mitigate this internal control weakness:

- An independent person who lists all receipts should agree them back to the treasurer's receipts ledger.
- An independent person should open bank statements and review them for unusual items, such as debit memos, and overdraft charges. This can be documented by the person initialing the envelope or bank statement.
- An independent person should complete bank reconciliation's or review the treasurer's bank reconciliations for accuracy. This can be documented by the person initialing the bank reconciliation.
- An independent person should compare fiscal court order approvals to invoices and cancelled checks.

County Finance Officer Eddie Campbell's Response:

Knott County will attempt to accomplish this recommendation.

PRIOR YEAR FINDINGS

In the prior year, it was reported that the fourth quarter financial statement did not reflect all the budget amendments. This issue was corrected and was not repeated in the current year.

CERTIFICATION OF COMPLIANCE -
LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM

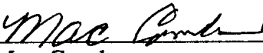
KNOTT COUNTY FISCAL COURT

For The Fiscal Year Ended
June 30, 2003

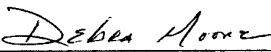
CERTIFICATION OF COMPLIANCE
LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM
KNOTT COUNTY FISCAL COURT

For The Fiscal Year Ended June 30, 2003

The Knott County Fiscal Court hereby certifies that assistance received from the Local Government Economic Assistance Program was expended for the purpose intended as dictated by the applicable Kentucky Revised Statutes.



Mac Combs
Acting County Judge/Executive



Debra Moore
County Treasurer

